IN THE

Supreme Court of the United States

OCTOBER TERM, 1973

No. 73-1249

THE JOHNS HOPKINS UNIVERSITY,
Cross-Petitioner,

v.

WILLIAM E. HUTTON; JOSEPH A. W. IGLEHART; JAMES J. LEE; WILLIAM C. MILLER; EARL K. BASSETT; JOHN M. BLEAKIE; ERNEST E. KEUSCH; BENJAMIN D. WILLIAMS; JOHN J. ANGLIM; REGINALD N. BARNARD; JUSTIN J. STEVENSON, JR.; J. LOGAN BURKE; JAMES M. HUTTON, III; THOMAS C. CAFONE; HART HAGIN; CLINTON J. COOMBS; ARTHUR T. HAMILL; JAMES M. HUTTON, III, EXECUTOR OF THE ESTATE OF DEFENDANT JAMES M. HUTTON, JR., DECEASED; ROBYN B. HALL, VERNON H. HALL, III and DUDLEY HALL, EXECUTORS OF THE ESTATE OF DEFENDANT VERNON H. HALL, II, DECEASED; and W. E. HUTTON & CO., A PARTNERSHIP,
Cross-Respondents.

CROSS-PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

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Cross-Petitioner The Johns Hopkins University (Hopkins) respectfully prays that a writ of certiorari issue to review the judgment and opinion of the United States Court of

Appeals for the Fourth Circuit entered December 4, 1973, and to correct erroneous holdings therein regarding the availability of the remedy of rescission, and the circumstances under which such remedy may be held to be unilaterally waived and relinquished, in an action brought by cross-petitioner Hopkins against respondents W. E. Hutton & Co. (Hutton), within the period of limitations, to rescind Hopkins' purchase of a security from Hutton for the fraud of Hutton in violation of Section 10(b) of the Securities Exchange Act (15 U.S.C. §78j(b)), and Section 17(a) of the Securities Act (15 U.S.C. §77q(a)).

OPINIONS BELOW

The opinion of the Court of Appeals sought to be reviewed is not yet officially reported. It is printed in the Appendix to the Petition of Hutton in No. 73-1166, beginning at page A-1.[1] It affirmed the summary judgment of the District Court for the District of Maryland, 326 F. Supp. 250 (D. Md. 1971) (App. B-1) and 343 F. Supp. 245 (D. Md. 1972) (App. C-1), that Hutton are liable to Hopkins for their fraud in the sale of a security in violation of Section 10(b) of the Securities Exchange Act of 1934 (15 U.S.C. §78j(b)), but reversed in part for a trial, with the burden of proof placed on Hopkins, of the question whether, solely because of the relatively short time which elapsed before it demanded the remedy of rescission, including the time during which Hopkins was ignorant of its right thereto, Hopkins had lost, by unilateral waiver, that particular remedy.

In an earlier opinion (App. F-1), the District Court had granted Hopkins a summary judgment of rescission of the same purchase for Huttons' same fraud as a violation of

[1] Future references herein to this Appendix will be indicated by "App." and the appropriate page reference.

Section 12(2) of the Securities Act of 1933 (15 U.S.C. §77l(2), 297 F. Supp. 1165 (D. Md. 1968). The Court of Appeals, in 422 F.2d 1124 (4th Cir. 1970) (App. E-1), had affirmed that summary judgment as to Huttons' violation of that statute, *and as to the sufficiency of Hopkins' tender and the propriety and equity of giving Hopkins the remedy of rescission*, but reversed for a trial of the question of Hopkins' compliance with the one-year statute of limitations contained in Section 13 of the Securities Act (15 U.S.C. §77m), compliance with which constitutes a part of the substantive cause of action created by Section 12(2) of the Securities Act, and which has peculiar application to that cause of action, but no application to claims under Section 10(b) of the Securities Exchange Act. These five opinions appear in the Appendix to Huttons' pending Petition for Certiorari in No. 73-1166 as above indicated.

JURISDICTION

The judgment of the Court of Appeals was made and entered on December 4, 1973. Hutton, in No. 73-1166 of this Term, filed a petition for certiorari to review it on January 30, 1974. This cross-petition for certiorari was filed within ninety (90) days of the date the judgment of the Court of Appeals was entered. This Court's jurisdiction is invoked under 28 U.S.C. §1254(1).

QUESTIONS PRESENTED

Hopkins' purchase of a security, induced and caused by fraudulent misrepresentations and omissions of Hutton in violation of Section 10(b) of the Securities Exchange Act, took place on March 1, 1961. Hopkins tendered back the security and rescinded the purchase on August 6, 1963, and instituted this action to recover the purchase price on November 1, 1963, well within the Maryland three-year

statute of limitations, the only such statute which could be applicable. Hopkins did not have any actual knowledge or direct information of Huttons' frauds (and no imputed or constructive knowledge thereof by shutting its eyes to any obvious facts) until shortly before it made demand on August 6, 1963 for rescission of the purchase. Hopkins did not take that short time for any speculative or other inequitable reasons, but only to verify and make sure of its grounds. (See Rules 9 and 11 of the Federal Rules of Civil Procedure.) Hutton were not prejudiced by any lateness in Hopkins' demand by any changes in the security since its purchase, or by any changes of Huttons' position, or otherwise.

The above circumstances have been judicially determined by the Courts below. No inequitable motive or advantage to Hopkins and no prejudice to Hutton were found. Therefore, no laches or estoppel by Hopkins existed.[2]

The overall Question Presented, therefore, is:

1. Whether, notwithstanding the above circumstances, Hopkins' right to rescind the purchase can be held to have been lost, by unilateral waiver and relinquishment through mere lapse of time, unless Hopkins bears the burden of proof and convinces a jury that it demanded rescission within a reasonable time, not merely from its actual knowledge or equivalent imputed knowledge, but from the time when, objectively considered, it might have obtained knowledge of Huttons' fraud by making a diligent, affirmative investigation.

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[2] The Court of Appeals mentioned no such defenses or any inequitable features resulting from the mere lapse of time. On the contrary, it held on the first appeal, and affirmed on the second, that "rescission is a proper remedy" for Hopkins' claim under Section 12(2) of the Securities Act 422 F.2d 1124, 1131 (App. E. 13). This could not be true if inequities in addition to mere lapse of time existed. Also it clearly held that Hopkins was entitled to and had not forfeited the relief of money damages.

The above overall question presents these subordinate questions:

2. Whether waiver by lapse of time is the intentional relinquishment of a known right, and must be determined subjectively, and, therefore, whether that part of the time which Hopkins took in demanding rescission of the fraudulent purchase which can be considered in determining waiver, must, as a matter of law, be calculated only from the time Hopkins knew, actually or by imputation, of the existence of the right to rescind and not, as the Court of Appeals held, objectively from the time it might have known of it as the result of affirmative diligence.

3. Whether waiver of the right of rescission (like laches, estoppel, the ordinary conventional statute of limitations, which is not an ingredient of the substantive cause of action, and other matters of avoidance) is a matter of affirmative defense and, therefore, whether the burden of proof with regard to it rests upon Hutton, the party who pleaded that defense, and not, as the Court of Appeals held, upon Hopkins, the party alleged to have unilaterally waived and relinquished the right.

STATUTORY PROVISIONS INVOLVED

The statutory provisions involved are Section 10(b) of the Securities Exchange Act of 1934 (15 U.S.C. §78j(b) and Section 17(a) of the Securities Act of 1933 (15 U.S.C. §77q(a)).

The regulations directly involved are Rules 10b-3 and 10b-5 of the General Rules and Regulations, Securities Exchange Act of 1934 (17 C.F.R. §240.10b-3 and 10b-5).

Other statutes involved are:

Section 12(2) of the Securities Act of 1933 (15 U.S.C. §77l(2)), for violation of which by Hutton the District Court,

in an earlier decision, awarded Hopkins a summary judgment of rescission (297 F. Supp. 1165 (D. Md. 1968)) (App. F-1) and which the Court of Appeals, in an earlier decision, affirmed except on the question of the one-year statute of limitations (422 F.2d 1124 (4th Cir. 1970)) (App. E-1).

Section 13 of the Securities Act of 1933 (15 U.S.C. §77m), the one-year statute which has peculiar application to claims under Section 12(2) of the Securities Act because regarded as a part of the substantive rights and causes of action created by Section 12(2), but which has no application to claims for violation of Section 10(b) of the Securities Exchange Act.

All of the above statutory provisions except Rule 10b-3 are printed in Addendum II to the Petition of Hutton in No. 73-1166.

The statute of limitations applicable to claims under Section 10(b) of the Securities Exchange Act and Section 17(a) of the Securities Act of 1933, which was fully complied with by Hopkins in the case at bar, is the three-year statute contained in Maryland Code, 1972 Replacement Volume, Article 57, Section 1, which reads as follows:

> "§ 1. Actions other than those upon specialties.
>
> All actions of account, actions of assumpsit, or on the case, except as hereinafter provided, actions of debt on simple contract, detinue or replevin, all actions for trespass for injuries to real or personal property, all actions for illegal arrest, false imprisonment, or violation of the twenty-third, twenty-sixth, thirty-first and thirty-second articles of the Declaration of Rights, or any of them, or of the existing, or any future provisions of the Code touching the writ of habeas corpus or proceedings thereunder, and all actions, whether of debt, ejectment or of any other description whatsoever, brought to recover rent in arrear, reserved under any form of lease, whether for ninety-nine years renewable forever, or for a greater

or lesser period, and all distraints issued to recover such rent shall be commenced, sued or issued within three years from the time the cause of action accrued; and all actions on the case for libel and slander and all actions of assault, battery and wounding, or any of them, within one year from the time the cause of action accrued."

Rule 10b-3 (17 C.F.R. §240.10b-3) reads as follows:

"It shall be unlawful for any broker or dealer, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange, to use or employ, in connection with the purchase or sale of any security otherwise than on a national securities exchange, any act, practice, or course of business defined by the Commission to be included within the term 'manipulative, deceptive or other fraudulent device or contrivance,' as such term is used in Section 15(c) of the Act."[3]

STATEMENT OF THE CASE

On March 1, 1961, Hopkins, as the result of long, urgent solicitations by Hutton, New York securities brokers (for many years well and favorably known to Hopkins and the members of its Finance Committee), purchased outright for its Endowment Fund from Trice Production Company (Trice), a prospector and developer of oil and gas properties, an oil and gas production payment. Trice's function thereafter was merely to operate the properties, which made the production payment an investment contract and, therefore, a "security". Hutton were paid a substantial commission for making the sale as brokers.

In December 1962, Hopkins for the first time suspected that it had been defrauded in making its purchase and began an investigation which led it to conclude shortly before July 26, 1963, that Hutton had defrauded it. On August 6, 1963, Hopkins tendered Hutton the production payment and de-

[3] Rule 15c1-2 is reproduced in the Addendum to the Cross-Petition.

manded rescission of the transaction, and on November 1, 1963, well within a three-year period of limitations from the date of purchase, filed its Complaint to rescind and recover its purchase money. Hopkins alleged, in Count I, that Huttons' material misrepresentations and omissions concerning estimates by independent engineers of the oil and gas reserves in the wells covered by the production payment violated Section 12(2) of the Securities Act of 1933 (15 U.S.C. §77l(2)); in Counts II and III, that they violated Section 10(b) of the Securities Exchange Act of 1934 (15 U.S.C. §78j(b)) and the Rules promulgated thereunder; and, in Count V, that they violated Section 17(a) of the Securities Act (15 U.S.C. §77q(a)). The Complaint contained other counts not now important.

After extensive discovery, Hopkins moved for summary judgment on all the above statutory counts. The District Court concerned itself in its first decision with Count I only, and granted Hopkins summary judgment of rescission under Section 12(2) of the 1933 Act. In reaching this conclusion the District Court found that Hopkins had "made a timely tender within the provisions of Section 12(2)" (App. F-117) and that "the equities of this case call for the application of the remedy of rescission" (App. F-122). With respect to the limitations requirements of Section 13 of the 1933 Act (15 U.S.C. §77m) the District Court found that "prior to that date [November 1, 1962] the undisputed facts reveal that plaintiff was not 'possessed of sufficient information to reveal' an even partial glimpse of the false and misleading nature of LaPiere's [Huttons' salesman's] communications, let alone the 'entire picture' of his misrepresentations" and, concluding that the question of whether due diligence was exercised involved simply the application of a standard and therefore a question of law, held that the action had been timely filed (App. F-114 to F-117).

The Court of Appeals concluded (App. E-13), "for reasons adequately stated by the district court, that rescission is a proper remedy . . ." and affirmed on all issues except the issue of compliance with the diligence requirement of Section 13 (15 U.S.C. §77m), holding that Hopkins' diligence should be tested by an *objective* standard and that there was a possible inference that, although Hopkins did not suspect, a reasonable man might have been alerted by certain events occurring after the purchase in 1962 to the possibility of fraud, and might then have begun an investigation which would ultimately have disclosed the fraud. This issue, the Court held, must therefore be remanded for trial. The Court of Appeals did not question the District Court's factual findings with respect to the lack of Hopkins' knowledge on November 1, 1962 and affirmatively held that, when Hopkins had, in the year 1962, received disturbing news with respect to Trice's financial condition and information of delays or reductions in production from certain wells, "Hopkins and its advisers did not stand idly by" but "conducted investigations which led them to believe that Trice's troubles, and Hopkins' own worries, were caused by factors other than deficiencies in the estimates of the future net revenue" (App. E-11), i.e. the estimates which Hutton, by its employee LaPiere, was guilty of misrepresenting.

On remand, Hopkins pressed its motion for summary judgment on Counts II, III and V brought under Sections 10(b) and 17(a), to which Section 13 of the Securities Act had no application and where the only applicable statute of limitations was the three-year Maryland statute. The District Court, after further discovery (particularly with respect to Hopkins' diligence in the period after November 1, 1962), and more briefings and hearings, found the additional elements of Huttons' *scienter* (B-8 to B-11) and Hopkins' reliance (B-11 to B-19) to be also shown by undisputed facts, and

entered summary judgment of Huttons' liability and granted Hopkins rescission under Section 10(b) of the 1934 Act and Section 17(a) of the 1933 Act. There is no question that the action under these sections was filed well within the Maryland three-year Statute of Limitations, the only statute of limitations which could be applicable to the causes of action created by these sections.

The District Court, relying upon *Pence v. Langdon*, 99 U.S. 578, and many other authorities defining and determining the legal elements of the affirmative defense of unilateral waiver (which Hutton pleaded as required by Rule 8(c) of the Federal Rules of Civil Procedure), concluded that Hopkins' demand for rescission under Section 10(b) should be "appraised under criteria substantially different from those imposed by Section 12(2) and the related Section 13 . . .," and granted the relief because Hutton had not sustained their burden of showing unreasonable delay on the part of Hopkins, subjectively considered, in making the demand for rescission after it had actual or imputed knowledge of the fraud. In so holding, the District Court made its view clear that imputed or constructive knowledge would be for this purpose the equivalent of actual knowledge. But it found on the undisputed evidence that Hopkins had not closed its eyes to any obvious facts. Applying this rule, the Court found it to be undisputed that the first information which Hopkins received subjectively indicating to it a possible deficiency in the reserves, but without any suggestion of fraud, was a preliminary statement of opinion, in November, 1962, from Bednar, a petroleum engineer. The District Court then recounted, step by step, Hopkins' investigation begun on December 14, 1962, which was thereafter diligently pursued and completed about July 26, 1963, on which date Hopkins made an appointment for a meeting with Hutton on August 6, 1963, at which it tendered back the security and demanded

rescission. Hutton, who were already carrying on an investigation of its employee, LaPiere, begun in February, 1963, and an investigation in anticipation of Hopkins' claim begun May 9, 1963, requested more time to investigate it, giving "complexity of the matter" as their reason; and they did not deny Hopkins' claim until October 10, 1963 (App. C-15 to C-20). Suit was filed on November 1, 1963.

On a second appeal by Hutton, which was heard by a panel of the Court of Appeals completely different from that which heard the first appeal and in which Hutton did not contest the District Court's finding of *scienter*, the District Court was affirmed as to Huttons' liability under Sections 10(b) and 17(a), and Hopkins' right to relief was recognized. Moreover, the Court of Appeals indicated no disagreement with the factual conclusions of the District Court.

Nevertheless, it reversed and remanded for a jury trial the question of Hopkins' right to obtain the particular relief of rescission. In so doing, the Court of Appeals held that the District Court had erred in concluding that the right to rescind should be determined on the basis of Hopkins' promptness in demanding it after it acquired knowledge, actual or imputed, of the fraud. Rather the Court of Appeals ruled generally that the rule of equity and the burden of proof here *are identical* with those enacted by Section 13 of the 1933 Act, and that all persons who desire to rescind fraudulently induced securities transactions, including Hopkins, have, regardless of other circumstances and of the particular statute conferring the right of action, the burden of persuading a jury that they exercised due diligence, objectively determined, to discover the fraud and that they demanded rescission promptly after the fraud *should have been* discovered in the exercise of such diligence, again applying an objective test (App. A-6 to A-7 footnote 12). It is

that determination which this Court is hereby asked to review.

REASONS FOR GRANTING THE WRIT

1. THE COURT OF APPEALS' DECISION REGARDING WAIVER OF THE RIGHT OF RESCISSION FOR FRAUD DIRECTLY CONFLICTS WITH THE APPLICABLE AND CONTROLLING DECISIONS OF THIS COURT, PARTICULARLY *PENCE v. LANGDON*, 99 U.S. 578 (1878).

Pence v. Langdon, 99 U.S. 578 (1878), this Court's clearest expression on the subject at hand, is a relatively old decision, but no later decision (until the one for which we seek review) has attempted to impair its authority in the slightest degree. On the contrary, it has been cited and used in recent years by many lower Courts in opinions written by judges of recognized great ability.

In *Pence*, plaintiff, in early 1875, purchased from defendant by correspondence stock in a mining company. Defendant told plaintiff, and plaintiff believed, he was buying the stock from the company. Plaintiff claimed that on June 20, 1875, when he visited the mine, he learned for the first time that he had been sold some of defendant's own stock at a price much greater than it was worth. The next day plaintiff rescinded for fraud and demanded return of his purchase price. He later brought an action at law for money had and received to recover the purchase price. The affirmative defenses interposed by the defendant included alleged waiver and acquiescence by reason of plaintiff's supposed delay in rescinding. This Court affirmed judgment for plaintiff on the jury's verdict.

The trial court instructed the jury as follows:

> "Before the plaintiff was required to affirm or rescind the contract, he must be shown to have had actual knowledge of the imposition practised upon him. It is not

enough to show that he might have known or suspected it from data within his reach."

The Supreme Court approved this instruction, saying:

"This, under the circumstances, we think, was exactly right."

The Trial Court also gave this instruction:

"If the jury believe that the plaintiff had no actual knowledge or belief that defendant had put his own stock upon them, until June, 1875, at the mine, then his repudiation of the transaction, if made then, was sufficient."

The Supreme Court approved this instruction also, saying:

"There can be no doubt as to the soundness of this proposition."

This Court also said:

"Acquiescence and waiver are always questions of fact. *There can be neither without knowledge.* The terms import this foundation for such action. One cannot waive or acquiesce in a wrong while ignorant that it has been committed. *Current suspicion and rumor are not enough. There must be knowledge of facts which will enable the party to take effectual action.* Nothing short of this will do. But he may *not wilfully shut his eyes to what he might readily and ought to have known. When fully advised,* he must decide and act with reasonable despatch. He cannot rest until the rights of third persons are involved and the situation of the wrongdoer is materially changed. Under such circumstances he loses the right to rescind and must seek compensation in damages. *But the wrong-doer cannot make extreme vigilance and promptitude conditions of rescission.* It does not lie in his mouth to complain of delay unaccompanied by acts of ownership, and by which he has not been affected. The election to rescind or not to rescind, once made, is final and conclusive.

> *"The burden of proving knowledge of the fraud and the time of its discovery rests upon the defendant."* (Emphasis supplied.)

It is manifest, that, except that in *Pence* suspicion and knowledge were simultaneous, whereas in the case of Hopkins the factual complexities caused several months to elapse between its first suspicion and completion of its investigation, the case at bar is on "all fours" with *Pence*. In neither case was there any laches, or estoppel, or delay for speculation, or other inequity accompanying the rescission. In both, passage of time alone was claimed to constitute waiver. But the ruling in *Pence* eliminates from the passage of time to be considered as waiver, the time during which the plaintiff lacked actual knowledge. And the ruling in *Pence* also places squarely on defendant the burden of proving the alleged affirmative defense of waiver.

In the case at bar, the District Court relied heavily upon *Pence*. But the Court of Appeals merely said of it: "We fail to find *Pence*, which involved the review of a trial court's instruction in an action at law, persuasive on the issue before us . . .". It will be noted that the Court of Appeals' only reason for concluding that *Pence* should be ignored was because its ruling was made in "*an action at law*" for rescission instead of in a proceeding in equity for the same relief. One would suppose that there is just as much reason to apply equitable principles of fairness where the rescission is sought in equity as where it is sought in an action at law for money had and received. Moreover, the Court of Appeals has remanded the case at bar for a trial of this issue which it held will require *instructions* to a jury upon waiver.

2. THE COURT OF APPEALS' DECISION REGARDING WAIVER OF THE RIGHT OF RESCISSION FOR FRAUD VIOLATIVE OF SECTION 10(b) OF THE SECURITIES EXCHANGE ACT DIRECTLY CONFLICTS WITH DECISIONS OF OTHER COURTS OF APPEALS, PARTICULARLY *ROYAL AIR PROPERTIES, INC. v. SMITH*, 312 F.2d 210 (9th Cir. 1962); 333 F.2d 568 (9th Cir. 1964).

In the first appeal in *Royal Air Properties, Inc. v. Smith*, 312 F.2d 210 (9th Cir. 1962), the Ninth Circuit held that, in an action under Section 10(b) of the Securities Exchange Act to rescind a purchase of a security for defendants' fraudulent material concealment violative of that statute, common law laches, estoppel and waiver were available to a defendant as *affirmative defenses*, if defendant could establish them by proof. On the second appeal, reported in 333 F.2d 568 (9th Cir. 1964), the Ninth Circuit affirmed the District Court in finding that defendant had failed to bear the burden of sustaining by proof any of these three asserted defenses. The Court of Appeals affirmed the findings as to laches and estoppel by saying that defendants had not shown that, after plaintiff had full knowledge of the fraud, they "suffered an injury or detriment sufficient to justify application of the defenses of laches or estoppel". However, its further ruling, and the reasons it gave for it, that the defense of unilateral waiver by mere lapse of time had also not been sustained by defendant is more important here.

Smith purchased his stock in an apartments company on May 16, 1957, as the result of misrepresentations of Heathman, a corporate officer, which included failure to inform Smith that one Hargess had been removed as President of the Company and had demanded repayment of a loan he had made to it. He did not institute his action to rescind until several years after his purchase, but within the applicable three-year Statute of Limitations of the State of

Washington. Before his purchase Smith knew that there had been "some difficulty between Hargess and Heathman". Heathman had then even asked Smith "not to talk with Hargess, in order to avoid widening their dispute". After his purchase, Smith became a director of the company and, at a meeting of the directors on August 29, 1957, first learned that the company had had "difficulty" with Hargess and that he had been removed as a director. At a later meeting of the directors on November 12, 1957, Smith learned that Hargess had demanded repayment of his loan and would not accept the company's stock in place of it. But Smith was not told, and did not know until August 1959, when he first questioned Hargess, that Hargess had made that demand for return of his money in April 1957 before Smith had purchased his stock.

The District Court found, and the Ninth Circuit approved, "that there were many factors which should have aroused plaintiff's suspicions . . . and that it would not have been difficult for him to have fully informed himself", and that Smith "was negligent — perhaps grossly so" in failing to make sooner the inquiries which were prompted and suggested by the alerting information he had about Hargess during the years in which he did nothing. But the District Court also concluded, and the Ninth Circuit affirmed, that this negligent lack of diligence could not constitute unilateral waiver of Smith's right to rescind. The Ninth Circuit said (333 F.2d 568, at p. 571):

> "It has been held by this court that waiver is 'the voluntary or intentional relinquishment of a known right. It emphasizes the mental attitude of the actor.' Since waiver is a voluntary act, there must be knowledge of the right in question before the act of relinquishment can occur."
>
> * * * * * *

"*When waiver is predicated upon facts of which one has inquiry, but not actual notice,* it is no longer intentional. *We feel that waiver of rights under the Securities Exchange Act of 1934 should be limited to those cases where it is intended, and that therefore the right in question must be found to be actually known before waiver becomes effective.* This is as it should be because there is a period of limitations applicable to cases brought under § 10(b); *the statutory period should not be cut short by a waiver with the mental element disregarded.*" (Emphasis added.)

3. THE COURT OF APPEALS HAS DECIDED FEDERAL QUESTIONS CONCERNING THE AVAILABILITY AND WAIVER OF THE REMEDY OF RESCISSION FOR FRAUD VIOLATIVE OF SECTION 10(b) OF THE SECURITIES EXCHANGE ACT, IN CONFLICT WITH BASIC PRINCIPLES OF LAW AND THE REMEDIAL PURPOSES OF THE STATUTE EXPRESSLY RECOGNIZED BY THIS COURT, WHICH QUESTIONS ARE OF GREAT AND RECURRING IMPORTANCE IN ITS APPLICATION.

The errors of the Court of Appeals spring from confusing the affirmative equitable defense of waiver by mere lapse of time with the objective requirement of the one-year statute of limitations contained in Section 13 of the Securities Act of 1933 (15 U.S.C. §77m). Waiver (like laches, estoppel and speculative delay) has been worked out by Courts of Equity as a judge-made defense (to be applied subjectively and personally) against the inequitable exercise of a right a defrauded person usually has to rescind the transaction. In direct contrast, Section 13 of the Securities Act is a special one-year statute of limitations, which by its terms has no application to a cause of action under Section 10(b) of the Securities Exchange Act, but objective compliance with which a plaintiff must bear the burden of proving (because, by reason of its wording and the fact that it was simultaneously enacted with the statute creating the cause of action,

it is an ingredient of his substantive cause of action) for any relief whatever for violation of Section 12(2) of the Securities Act.

The Court of Appeals erroneously treated these two utterly different principles of law as being practically identical. Without citation of any authority which supports the proposition, it rejected the District Court's conclusion "that Hopkins' conduct in seeking rescission under Sections 10(b) and 17 should be appraised under criteria substantially different from those imposed by Section 12(2) and the related Section 13 requirement" (the one-year statute of limitations) (App. A-8). And, again without citation of a single case to support it, the Court of Appeals also held that "in the general area of rescission it appears that the requirement of prompt action is an element of the plaintiff's case, and the burden is upon the rescinding party to show that he acted promptly in seeking rescission". Such identification of the two rules would, of course, make Section 13 surplusage when rescission under Section 12(2) is sought. These rulings of the Court of Appeals are in head-on conflict with basic principles of law which have often been announced and applied by this Court and numerous other Courts of Appeals and District Courts. It thereby erred (1) by its determination of the legal elements of the defense of unilateral waiver by lapse of time; (2) by including in the elapsed time which could constitute such waiver, time during which Hopkins asserted no right because admittedly it was then ignorant of the existence of the right claimed to be waived; (3) by holding that waiver should be applied objectively (and not equitably, subjectively and personally) to cut off the equitable right of rescission; and (4) by imposing on Hopkins the burden of proving that it had not so objectively and unknowingly waived its right.

Correction of these errors now by this Court would speedily end this interminable case and bring justice to Hopkins, and the innocent victim of Huttons' fraud, for which at enormous expense it has battled *for over ten years* to obtain redress. It would relieve this charitable educational institution from suffering great additional delay and expense which will be required by a jury trial to determine its right to this particular relief.

But the *all-pervading* reason for granting the writ is because of the confusion and adverse effect these errors of the Court of Appeals are bound to have upon constantly recurring problems in the administration of, and heavy litigation under, the now all-important Federal securities statutes. The Court of Appeals' rulings are of general application and place this burden of proof of objective diligence upon *every* defrauded would-be rescinder *regardless of circumstances.*

This Court has repeatedly stressed the "remedial purposes" of the Federal securities legislation and has called specific attention to the power conferred by Section 27 of the Securities Exchange Act (15 U.S.C. §78aa) to fashion remedies appropriate to carry out these purposes. *SEC v. Capital Gains Research Bureau*, 375 U.S. 180, 186, 195 (1963); *J. I. Case Co. v. Borak*, 377 U.S. 426, 433 (1964); *Supt. of Insurance v. Bankers Life & Casualty Co.*, 404 U.S. 6, 12 (1971); *Affiliated Ute Citizens v. U. S.*, 406 U.S. 128, 151 (1972). The errors of the Court of Appeals, by its novel and severe restrictions on a usual remedy of defrauded purchasers of securities, conflict directly with these remedial purposes. In enacting these securities statutes Congress expressly made null and void stipulations "binding any person acquiring any security to waive compliance with any provision" of them, 15 U.S.C. §77n and §78cc. See *Wilko v. Swan*, 346 U.S. 427 (1953). The erroneous severe restrictions

which the Court of Appeals has placed upon the right of an innocent purchaser of a security to rescind the transaction for fraud clash with the Congressional policy, manifested by these enactments, of a hostility which extends to waivers of such legal rights, even knowingly and voluntarily made for consideration, by purchasers of securities.

The only decisions which the Court of Appeals cited as supposed authority for these novel rulings upon (1) what legally constitutes the affirmative defense of waiver and (2) who has the burden of proof with regard to it, were:

Newberg v. American Dryer Corp., 195 F. Supp. 345 (E.D. Pa. 1961);

Premier Industries v. Delaware Valley Financial Corp., 185 F. Supp. 694 (E.D. Pa. 1960);

Shonts v. Hirliman, 28 F. Supp. 478 (S.D. Cal. 1939);

Fischman v. Raytheon Mfg. Co., 9 FRD 707 (S.D. N.Y. 1949);

Holmberg v. Armbrecht, 327 U.S. 392, 397 (1946);

Bailey v. Glover, 88 U.S. 342, 348 (1874);

Wood v. Carpenter, 101 U.S. 135 (1879);

Azalea Meats, Inc. v. Muscat, 386 F.2d 5, 8 (5th Cir. 1967); and

Baumel v. Rosen, 412 F.2d 571 (4th Cir. 1969).

But in none of these nine cases, except the last, was there any question whatever of unilateral waiver. The first eight involved extensions of statutes of limitations.

The first four of these cases are completely inapposite, because they merely recognize that Section 13 of the Securities Act (15 U.S.C. §77m), expressly providing (tailor-made exclusively for causes of action under Sections 11 and 12(2) of that Act) a special one-year statute of limitations running from the time the fraud should have been discovered by the

exercise of reasonable diligence, is not the ordinary conventional statute of limitations merely cutting off remedies but is an ingredient of the substantive causes of action created by Sections 11 and 12 of the same statute; and that, *for that reason alone*, the burden of proof as to compliance with it is on the plaintiff. See 3 Loss, *Securities Regulations* (2d ed.) p. 1744. But it is fundamental that Section 13 of the Securities Act may not be borrowed as the statute of limitations applicable to causes of action under Section 10(b) of the Exchange Act. The statutes of limitations of the forum States are borrowed instead for such causes of action, and they, including the three-year Maryland statute applicable to Hopkins' claim, are *conventional* statutes of limitations which go only to the remedy and which must be pleaded as affirmative defenses by the defendant under Rule 8(c) of the Rules of Civil Procedure, who must also bear the burden of proof of establishing them.

In *Holmberg*, the Court of Appeals erroneously thought it was bound to apply strictly a New York ten-year statute of limitations to bar a cause of action in equity created by Federal law, which it was alleged the defendant had fraudulently concealed from the plaintiff. The Supreme Court reversed and remanded for a determination of whether, "by reason of some inequity founded on some change in the condition or relations of the property or the parties", the cause of action might be barred by *laches*. In its opinion, the Supreme Court criticised the lower court, not only for holding that the state limitations period was required to be applied, but also for the Court's attempted strict application of such a statute without considering that the accrual of the cause of action might well have been extended by the defendant's concealment of it, notwithstanding plaintiff's diligence to discover it. But, in the case at bar, we have, first, no question of *laches*, because we have no finding of any

inequity caused Hutton by any time which Hopkins took in demanding rescission. And, second, we have no question here of extending the statute of limitations by postponing accrual of the cause of action because of its fraudulent concealment. The Maryland statute of limitations gave Hopkins three years from March 1, 1961 to bring its action. Hopkins brought its action well within that three-year period and needed no extension. Neither the decision in *Holmberg* nor its *dicta* have any relevance here.

Similarly, *Bailey v. Glover*, *Wood v. Carpenter* and *Azalea Meats, Inc. v. Muscat*, are not in point here. The first two announce and apply the equitable rule which extends, by postponing accrual of the cause of action (but postpones it *only for a diligent plaintiff*), the running of limitations when his cause of action has been concealed from him by fraud. In *Azalea Meats, Inc.*, the Fifth Circuit defined "discovery", for purposes of such extensions provided in a Florida statute of limitations, to include discovery which could have been had by reasonable diligence. Hopkins had no occasion to invoke the doctrine of these cases, because it sued within the statutory period unextended.

Rule 8(c) of the Federal Rules of Civil Procedure expressly requires that waiver (along with laches, estoppel and the conventional statute of limitations) is an affirmative defense which a defendant must plead to avoid waiving it. It follows that the defendant has the burden of proof to establish the defense. See 3 *Black on Rescission and Cancellation* (2d ed.) p. 1481; *McCormick on Evidence* §318; *Reliance Life Insurance Co. v. Burgess*, 112 F.2d 234, 237-38 (8th Cir. 1940); *Joslyn v. Cadillac Automobile Co.*, 177 Fed. 863 (6th Cir. 1910). Presumptions often shift, not the burden of ultimate proof, but the burden of coming forward with evidence; so, in exceptional cases of very long delay, a plaintiff is required to explain it, but only in such cases. Such cases

include *Badger v. Badger*, 69 U.S. 87 (a delay of 31 years) and *Marsh v. Whitmore*, 88 U.S. 178 (a delay of 11 years). Hopkins demanded rescission within 2½ years from the time of Huttons' fraud.

Instead of placing reliance upon the eight inapposite decisions described above, the Court of Appeals should have accorded weight to *Pence v. Langdon*, 99 U.S. 578 (1878), *Royal Air Properties, Inc. v. Smith*, 333 F.2d 568 (9th Cir. 1964), and to the host of authorities which, in many different applications, (a) define waiver to be the intentional voluntary relinquishment of a known right, and (b) hold it to be an affirmative defense which must be pleaded and proved by the defendant. Such authorities include; *Johnson v. Zerbst*, 304 U.S. 458, 464 (1938); *Ohio Bell Telephone Co. v. P.U.C.*, 301 U.S. 292, 307 (1937); *Green v. United States*, 355 U.S. 184, 191 (1957); *Fay v. Noia*, 372 U.S. 391, 439-440 (1963); *Barker v. Wingo*, 407 U.S. 514, 525-526 (1972); *U. S. ex rel. Snyder v. Mazurkiewicz*, 413 F.2d 500, 502-03 (3rd Cir. 1969); *U. S. ex rel. Linde v. Brierley*, 437 F.2d 324, 326 (3rd Cir. 1970); *United Forest Products Co. v. Baxter*, 452 F.2d 11 (8th Cir. 1971); and the numerous other decisions of the lower federal courts as to this and other affirmative defenses collected in *2A Moore, Federal Practice*, 1858-63.

The Court of Appeals did, however, cite one decision on the question of waiver, *Baumel v. Rosen*, 412 F.2d 571 (4th Cir. 1969). In *Baumel* a different panel of the Fourth Circuit had applied the defense of unilateral waiver to deny a plaintiff rescission (awarding him damages instead) in a Section 10(b) case, although his suit was brought within the Maryland three-year statute of limitations. But the factual situation in *Baumel* was completely different from that in *Hopkins v. Hutton*. The security which Baumel was defrauded into selling the defendants, Gulf American common stock, was known to be a great speculation and subject to

enormous fluctuations in value. *Baumel* was found to have deliberately waited and postponed his decision to rescind for speculative purposes for 35 months, during all of which time he *suspected*, had "wind of the malodor", and indeed, "believed" he had been defrauded, — having, during the last 18 months of that speculative waiting period, *full and complete knowledge of the fraud.* During the time Baumel delayed in order to speculate, a 500 share unit of his stock, by stock splits, became 69,200 shares, and, adjusting prices to reflect the stock splits, the value of his stock fluctuated up and down between a low of 14½ cents a share and a high of $15.75 a share.

The decisions which the Fourth Circuit cited for its holding in that case, namely, *McLean v. Clapp*, 141 U.S. 429, 432 (1891) (11 years delay with full knowledge); *Twin-Lick Oil Co. v. Marbury*, 91 U.S. 587, 592-593 (1875) (4 years delay with full knowledge), were both cases of long conscious delays for speculative purposes. The dictum for which *Estate Counseling Service, Inc. v. Merrill Lynch, Pierce, Fenner and Smith, Inc.*, 303 F.2d 527, 532 (10th Cir. 1962) was also cited stressed the same feature.

Baumel's conscious inequitable conduct justified the Fourth Circuit's decision that it constituted the defense of waiver to his claim to rescind. But in no sense can *Baumel* stand as authority for the present holding that Hopkins has the burden of showing that it did not relinquish its right of rescission by mere lapse of time unaccompanied by any speculation or other inequitable feature or result, during which it neither knew nor suspected that it had been defrauded or had such right.

In addition to the nine decisions analyzed above, the Court of Appeals in the case at bar quoted (App. A-9) as authority an excerpt from Section 917 of *Pomeroy's Equity Jurispru-*

dence, Vol. 3 (5th ed. 1941) to the effect that, after a would-be rescinder has actual or imputed knowledge of the fraud, his delay generally will be "regarded as an *acquiescence*", i.e. a waiver of his right to rescind. But it is clear from this quotation itself, reenforced by the remaining text of this section which the Court of Appeals does not quote, that Pomeroy, by the term "imputed" knowledge, means here that the would-be rescinder *deliberately shut his eyes to obvious facts* pointing to fraud and not merely failed to investigate diligently when he had no suspicions. Section 917 continues as follows after the quotation selected by the Court of Appeals:

> "To this rule there is one limitation: it applies only when the fraud is known *or ought to have been known.* No lapse of time, no delay in bringing the suit, however long, will defeat the remedy, provided the injured party was, during all this interval, *ignorant of the fraud.*" (Italics supplied.)

CONCLUSION

It is manifest that the Court of Appeals, in the face of controlling contrary decisions, committed serious error of great contemporary importance in litigation under the securities statutes, in imposing upon victims of fraud who demand rescission and sue to rescind within the applicable period of limitations and shortly after they know that they have been defrauded, the burden of proving that they have not waived their right to rescind by failing to investigate and discover the fraud before they even suspected it and by failing to demand rescission within a reasonable period from the time they might have discovered it.

Respectfully submitted,

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Attorneys for Cross-Petitioner.

February ....., 1974

ADDENDUM I

Statute Involved

Rule 15c1-2 of the Securities and Exchange Commission (17 C.F.R. §240.15c1-2).

"(a) The term 'manipulative, deceptive, or other fraudulent device or contrivance,' as used in Section 15(c)(1) of the Act, is hereby defined to include any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person.

(b) The term 'manipulative, deceptive, or other fraudulent device or contrivance,' as used in Section 15(c)(1) of the Act, is hereby defined to include any untrue statement of a material fact and any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, which statement or omission is made with knowledge or reasonable grounds to believe that it is untrue or misleading.

(c) The scope of this rule shall not be limited by any specific definitions of the term 'manipulative, deceptive, or other fraudulent device or contrivance' contained in other rules adopted pursuant to Section 15(c)(1) of the Act."

CERTIFICATE OF SERVICE

I hereby certify that on FEB 12 '74, 1974, I served upon Petitioners, Cross-Respondents, three copies of the foregoing Cross-Petition for a Writ of Certiorari by depositing said copies in a United States post office, with first class postage prepaid, addressed to Petitioners' and Cross-Respondents' attorneys of record at their post office address:

John A. Wilson, Esquire and
Michael J. DeSantis, Esquire
53 Wall Street
New York, New York 10005.

I further certify that all parties to be served have been served.

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